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UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

SEP 25 1996

IN RE:

DALE K. SANDVALL AND
DONNA L. SANDVALL,

Debtors

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CASE NO. 4:92-CV-335-Y

UNITED STATES OF AMERICA,

Appellant,

v.

DALE K. SANDVALL AND
DONNA L. SANDVALL,

Appellees.

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APPEAL FROM:

BANKRUPTCY NO. 490-44107-MT-7

ADVERSARY NO. 491-4004

ORDER ON APPEAL

The United States appeals the decision of the United States Bankruptcy Court, Northern District of Texas, Fort Worth Division, to dismiss the United States's adversary proceeding against debtors Dale K. Sandvall and Donna L. Sandvall ("the Debtors"). The Court has jurisdiction to consider the bankruptcy court's orders pursuant to 28 U.S.C. § 158(a). After careful consideration of the parties' briefs, the record on appeal, and the relevant law, the Court finds that the bankruptcy court's order and judgment dismissing the adversary proceeding should be REVERSED.

I. BACKGROUND

The Debtors filed for relief under Chapter 7 of the United States Bankruptcy Code on November 29, 1990. On January 8, 1991,

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the United States, acting on behalf of the Internal Revenue Service (the "IRS"), filed a complaint to object to the discharge of the Debtors pursuant to 11 U.S.C. § 727(a). The Debtors owe the IRS over two million dollars in unpaid taxes,¹ as determined in part by the Court of Appeals for the Fifth Circuit.² The United States objects to the discharge because the Debtors failed to disclose in their bankruptcy schedules their ownership--and alleged subsequent loss--of approximately \$566,462 in cash which, as their attorney admitted to the bankruptcy court, the Debtors concealed in their children's treehouse where it was, at some point, allegedly stolen.

The parties attempted to negotiate a settlement in the adversary proceeding, but ultimately failed. During negotiations, the Debtors refused to give the IRS an agreed judgment of non-dischargeability under § 727 and would only acquiesce to a non-discharge of the tax debt under 11 U.S.C. § 523. As part of the settlement, the Debtors wanted to keep their quarter-million dollar home, their family suburban, worth approximately \$20,000, and their son's bass boat. Furthermore, the Debtors insisted on being allowed to service their monthly mortgage payment, approximately \$2000, under any proposed pay-back agreement.

¹The amount quoted by the Debtors' counsel is \$2,218,969.13, which is approximately 99.68 of the total indebtedness listed in their bankruptcy schedules in the amount of \$2,225,982.88.

²The Fifth Circuit also determined that the Debtors had hidden money in sham trusts, and the court roundly admonished the Debtors for failing to pay their fair share of taxes: "The time has come for them to join the rest of their fellow citizens at the annual income roundup." Sandvall v. C.I.R., 898 F.2d 455, 459 (5th Cir. 1990).

The United States claims the IRS never actually offered--much less agreed to--these terms, and the bankruptcy court's findings of fact state that the parties could not reach a mutual settlement agreement. But in an apparent contradiction, the court's findings also state that the IRS initially agreed to allow the Debtors to keep the car and the house, which offer the Debtors accepted, but which the government later withdrew.

At a pre-trial conference held on October 30, 1991, the parties brought these negotiations to the court's attention. The Debtors claimed that, as taxes are non-dischargeable in any event under 11 U.S.C. § 523, the IRS would get all that it wanted from them if it would allow the discharge to proceed and accept a repayment plan, to be negotiated after the discharge. The IRS responded that, in fact, it would not get all that it wanted under their proposed settlement, as its primary purpose in filing the objection to the discharge under § 727 was not to collect on the debt--which it will doubtless attempt to do regardless of the outcome here--but rather to punish the Debtors for their admitted acts of fraud upon their creditors and the bankruptcy court. Furthermore, the government argued that, given the Debtors' acts of fraud, it was inequitable to allow them to keep their quarter-million dollar home when honest debtors in straits with the IRS lost theirs to pay for taxes owed.

The bankruptcy court was not much impressed by the IRS's position at the pretrial conference and went so far as to inquire why the IRS was "out for blood" against the Debtors. The court

then ordered the Debtors to file a motion to dismiss the adversary proceeding, which the Debtors did and which the court granted on April 7, 1992, after a brief hearing of argument only. It is this dismissal that the United States now appeals.

II. ANALYSIS

The United States raises three issues on appeal, but the Court will only address whether the bankruptcy court abused its discretion by dismissing the adversary proceeding, which it did pursuant to rule 7041 of the Federal Rules of Bankruptcy Procedure. The rule states in relevant part: "Dismissal of Adversary Proceedings. Rule 41 F.R.Civ.P. applies in adversary proceedings" Fed. R. Bankr. Proc. 7041. Rule 41(b) of the Federal Rules of Civil Procedure states in part:

Involuntary dismissal: Effect Thereof. For Failure of the plaintiff to prosecute or to comply with these rules or any order of court, a defendant may move for dismissal of an action or of any claim against the defendant.

This Court reviews the bankruptcy court's dismissal under Rule 41(b) for failure to prosecute to determine if the court abused its discretion, Connolly v. Papachristid Shipping Ltd., 504 F.2d 917, 920 (5th Cir. 1974), and dismissal "is appropriate only where there is a clear record of delay or contumacious conduct and lesser sanctions would not serve the best interests of justice." Wrenn v. American Cast Iron Pipe Co., 575 F.2d 544, 546 (5th Cir. 1978).

From the findings of fact and conclusions of law, the Court discerns that the bankruptcy court dismissed the adversary proceeding because the government would not come to terms on a

settlement agreement, or in the alternative, because the IRS withdrew an offer which the Debtors had already accepted.³ The record on appeal reveals no evidence whatsoever of delay in prosecuting this case on the part of the United States, nor is there any report of the government failing to comply with an order of the court or with any rules. Furthermore, it is apparent from the transcripts of the pre-trial conference and the dismissal hearing that the court never considered a lesser sanction against the government for its failure to settle, if such a failure even warrants a court sanction. Finally, the United States claims that it stood ready for trial at the time of the dismissal hearing, and this Court can find nothing in the record which controverts its assertion. In short, there is no clear record of delay or contumacious conduct which could support the bankruptcy court's dismissing the adversary proceeding for lack of prosecution.

Failing to reach a settlement before a trial on the merits is a fairly common occurrence, and as the very purpose of our court system is to resolve disputes among parties who cannot--or will not--do so on their own, it was a clear abuse of discretion for the bankruptcy court to dismiss for lack of prosecution on the facts here. This Court will REVERSE the bankruptcy court's order of dismissal and order the adversary proceeding REINSTATED.

³The court's findings are inconsistent on this point. Either the parties never reached a mutual, legally binding agreement, or they made an agreement and the IRS breached it by not honoring its terms--but the parties could not, contrary to the court's findings, have done both.

III. ORDER

IT IS THEREFORE ORDERED that the United States Bankruptcy Court's order of dismissal entered in the adversary proceeding below for lack of prosecution be REVERSED, and the adversary proceeding be REINSTATED. The case is REMANDED to the bankruptcy court for further proceedings not inconsistent with this order.

SO ORDERED.

SIGNED September 24, 1996.



TERRY R. MEANS
UNITED STATES DISTRICT JUDGE

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